

**STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
300 Capitol Mall, 16th Floor
Sacramento, California 95814**

RH05049272

April 14, 2006

INITIAL STATEMENT OF REASONS

California Insurance Commissioner John Garamendi will consider amendment of Title 10, Chapter 5, Subchapter 7.7, Section 2697.6 of the California Code of Regulations (CCR) regarding Earthquake Policies, Coverage Types and Limits.

SPECIFIC PURPOSE OF THE REGULATION

The proposed amendment will increase building-code-upgrade coverage limits and broaden the optional coverage choices.

NECESSITY

The California Earthquake Authority (“CEA”) was established by Legislative enactment. The CEA only writes the earthquake line of insurance and is managed as a public instrumentality of the State of California, but is funded mostly with private monies. Formed in response to the widespread unavailability of homeowners and earthquake insurance after the 1994 Northridge earthquake, the CEA considers one of its fundamental objectives to be increasing the availability of earthquake insurance.

The CEA writes a single policy of residential earthquake insurance, which has been divided through regulation into base-limits and supplemental-limits coverages. 19 insurers contract with the CEA to meet their legal mandate to offer earthquake coverage in California (“participating insurers”). CEA earthquake insurance is available only to California homeowners, condominium owners and renters who maintain certain types of policies with participating insurers. All such policyholders are eligible to purchase CEA earthquake coverage, but only about 13% of eligible homeowners, renters and condominium owners currently do so (about 750,000 policyholders). Before the creation of the CEA, such policyholders purchased earthquake coverage at two to three times this rate.

As recent catastrophic events have demonstrated (most prominently, Hurricane Katrina), the importance of widespread and adequate earthquake insurance coverage cannot be overstated. The CEA has been exploring ways to increase the number of policyholders who carry earthquake insurance. The CEA’s research and public input have indicated that homeowners would strongly support more choices in supplemental-limits coverages, which in turn would make the CEA product more useful to them and therefore more attractive to purchase. Additionally, a review of the CEA’s limited loss experience, from the date of its inception, suggests that its current base-limits building-code-upgrade coverage may not be sufficient. This proposed amendment would both increase the flexibility of coverage options for current and future CEA policyholders and double the amount available for building-code-upgrade coverage.

On April 29, 2004, under authority granted by Insurance Code section 10089.7, the Governing Board of the CEA (whose voting members consist of the Governor, the Treasurer, and the Commissioner, or their designees) voted to approve further study of policy changes that included an increase in building-code-upgrade coverage and “unbundling” of the present supplemental-limits-coverage packages. The Governing Board (“Board”), at its August 25, 2005 meeting approved these items as part of a larger plan that also included a 22.8% overall statewide average rate decrease for base limits coverages and adjusting the rating factors that are used to calculate the premium.

However, the Board’s action is not alone sufficient for implementation of these policy changes. Insurance Code section 10089.11 (b) requires that the Commissioner promulgate regulations that define CEA coverage types and limits. Such regulations are in place, but the existing regulations do not authorize the aforementioned Board-approved policy changes. Therefore, in addition to the Board’s approval, this regulatory amendment is required in order to implement the aforementioned policy changes.

TECHNICAL, THEORETICAL, AND/OR EMPIRICAL STUDY, REPORTS, OR DOCUMENTS

The Commissioner has relied upon the CEA Governing Board’s discretion and the expertise and recommendations of the CEA staff, Product Enhancement Committee, and Advisory Panel. The following documents with attachments were provided to the CEA Governing Board for consideration prior to its approval of the policy changes:

1. Agenda Item 7, Governing Board Memorandum, April, 29, 2004: CEA ‘Product Enhancement Committee’: Proposed Product Enhancement Concepts
2. Agenda Item 8, Governing Board Memorandum, June 30, 2005: CEA Product Enhancement Update

REASONABLE ALTERNATIVES TO THE REGULATION AND THE AGENCY’S REASONS FOR REJECTING THOSE ALTERNATIVES

No other alternatives to the regulation (including alternatives to lessen any adverse impact on small business) were presented to or considered by the Commissioner. The Commissioner has determined that the proposed amendment will only affect insurance companies and will therefore not affect or impact small business. Pursuant to Government Code section 11342.610(b)(2), insurers are not small businesses. All reinsurers are necessarily insurers.

EVIDENCE SUPPORTING FINDING OF NO SIGNIFICANT ADVERSE ECONOMIC IMPACT ON ANY BUSINESS

The only anticipated economic impact on a representative business is that Insurers participating in the CEA may incur implementation costs in reasonable compliance with the proposed amendment. However, these costs will be reimbursed pursuant to Insurance Code Section 10089.28(a).